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NOMINATION OF CHARLES COLEMAN COX

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

THE NOMINATION OF CHARLES COLEMAN COX TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION FOR A TERM ENDING JUNE 5, 1988

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NOMINATION OF CHARLES COLEMAN COX

WEDNESDAY, NOVEMBER 9, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Tower, Heinz, D'Amato, Hecht, Proxmire, and Sarbanes.

OPENING REMARKS OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

The purpose of this morning's hearing is to consider the nomination of Charles Coleman Cox to be a Commissioner of the Securities and Exchange Commission.

We are happy to have you before us, Mr. Cox, this morning and I understand you have an opening statement you wish to make.

Before I turn to you, I would ask Senator Proxmire if he has any opening statement he wishes to make.

Senator PROXMIRE. I have no opening statement.

The CHAIRMAN. Please proceed, Mr. Cox.

STATEMENT OF CHARLES COLEMAN COX, NOMINATED TO BE A COMMISSIONER OF THE SECURITIES AND EXCHANGE COMMISSION

Mr. Cox. Thank you, Senator.

To start, I would like to make five brief comments. First, I am honored and excited at the prospect of serving the public as a Commissioner on the Securities and Exchange Commission. Second, I intend to serve the full term for which I have been nominated. Third, my experience as chief economist at the Commission has shown me what an excellent staff the Commission has. They are highly skilled and dedicated people. Fourth, my economic skills will be a valuable complement to the legal and accounting talent at the Commission in pursuit of both investor protection and market efficiency. Fifth, I have heard a lot of talk that I'm Chairman Shad's pawn. That notion is absolutely wrong. I am independent. If you gentlemen have any doubts, I will dispel those today.

I am ready to answer any questions that you may have.

The CHAIRMAN. Thank you very much, Mr. Cox. Can I first have you sworn before we ask you to respond to questions.

[Whereupon, the witness was duly sworn.]

The CHAIRMAN. Mr. Cox, I understand you have a Merrill Lynch cash management account which you will liquidate immediately following confirmation; is that correct?

Mr. Cox. Yes, sir.

The CHAIRMAN. I understand that you own shares in Global Marine Co. which are listed securities and that you will recuse yourself from any matters before the Commission dealing with Global Marine if you're confirmed; is that correct?

Mr. Cox. Yes, sir. My plan is to sell those shares so that there will be no conflict.

The CHAIRMAN. I understand you're on leave of absence without pay from the Texas A&M University as a professor and that you intend to return there after your service with the Commission.

If you are confirmed, will you recuse yourself from any matters before the Commission dealing specifically with Texas A&M University?

Mr. Cox. Senator, I certainly would. I would consult with the ethics counsel at the Commission and abide by her advice.

The CHAIRMAN. What you're saying, then, is that you will avoid not only the conflict of interest but the appearance of any conflict of interest?

Mr. Cox. Yes, sir.

The CHAIRMAN. Do you agree to appear before this and any other duly constituted committees of the Congress when requested to do so?

Mr. Cox. Yes, sir.

The CHAIRMAN. Mr. Cox, what special contributions do you think you can make to the Commission? Do you feel your background and training as a Ph.D. in economics have application in your service as a Commissioner of the Securities and Exchange Commission?

Mr. Cox. I think that my economic skills provide a valuable complement as the Commission pursues its task of enforcing and administering the securities laws. I have spent my academic years studying Government regulation and how it works, so that will help me in my job.

My economic skills will help me assess cost-benefit estimates. They will also help in analyzing indirect or unintended effects of rule proposals.

Furthermore, work that I have done previous to my employment at the Commission, research on organized markets and information, will prove valuable. My work has shown how information is the key to market efficiency and one way of looking at the Commission's job is that it is in the information business.

The CHAIRMAN. What changes would you like to see made at the Commission over the next 5 years, just in a general sense? Having worked there, are there recommended changes you think that ought to be made?

Mr. Cox. Senator, as I said in my opening statement, I have noticed the great staff at the Commission. Its high dedication and extreme skill has clearly made the Securities and Exchange Commission the best Government regulatory agency. That excellence is

shown in the U.S. capital markets where as a result of investor confidence and market efficiency, largely due to the role of the Securities and Exchange Commission, the U.S. capital markets are the best in the world. However, as a Commissioner I would try to persuade the Commission to make better use of economic analysis. Past Commissioners, such as Philip Loomis and past Chairmen such as Roderick Hills, have had the goal of better use of economics. I intend to do something about that.

The CHAIRMAN. Would you briefly discuss your thoughts concerning proposals for a national market system?

Mr. Cox. The national market system question is very complicated and contains a number of issues such as market linkage, offboard trading restrictions, market fragmentation, and order exposure rules. Each of these issues in itself is complex; but overall, I advocate a fair and efficient market system which accurately matches buyers and sellers, and where traders can transact at low cost.

The Commission has taken steps toward implementing a national market system as directed by the 1975 amendments to the securities laws. Currently, there is an experimental linkage of over-the-counter and exchange-traded securities. This experiment is under review by the Commission to see whether it has contributed to market efficiency, whether it is indeed a step toward a national market system. Some people think that we already have a national market system. Others say that the experiment should be expanded.

My view is that we should continue to study it. The experiment has produced few results. No one has shown harm, but no one has shown benefits of this linkage. I think that aspect is very important.

The CHAIRMAN. We all know that our national capital markets must encourage greater capital formation. Generally, what action can the SEC take to increase capital formation while keeping the markets open.

Mr. Cox. Senator, I think that the Commission's policy of carefully reviewing its rules with a goal of keeping investor protection high but seeing if there are alternative ways which companies can meet the disclosure requirements at a lower cost is an important step in that direction.

The CHAIRMAN. The SEC has announced its proposed intention to regulate certain banks' securities activities which have historically been exempt from such regulation. Are you familiar with this proposal and, if so, what is your view on it?

Mr. Cox. Yes, Senator, I am familiar with it. The question about banks getting into the securities industry and securities firms getting into banking is one as to which we are anxiously awaiting action from Congress. But in looking ahead, the Commission has taken the view that it would be prudent to put out for comment the proposal that you refer to. The idea is that the Commission must be prepared. If there is further crossover of banking into the securities area without guidance by new legislation, the Commission wants to be certain that investors are protected. So I think it was prudent to issue this proposal for comment.

The CHAIRMAN. Last year the SEC adopted a temporary rule permitting issuers of securities to file a registration statement covering securities which would be publicly sold over a period of time, the so-called SEC shelf registration rule. What is your opinion of this experiment? Has it reduced paperwork and does it adequately protect public investors?

Mr. Cox. Rule 415, the shelf registration rule that you refer to, will be acted upon by the Commission in an open meeting tomorrow. My office studied the effects of shelf registration on the cost of issuing securities. Our results show that it has reduced issue costs for companies.

There are other important questions associated with that rule. These include whether due diligence requirements are met and possible effects on the structure of the broker-dealer industry, especially regional broker-dealers, and their role in distributing securities.

The evidence on cost is very clear. There have been benefits for new issuers. The evidence of effects on regional underwriters is less clear. However, I believe that any ill effects at that level are outweighed by the other benefits. Due diligence is an area in which I have less expertise.

On what I know now about the rule, I support it as an improvement in regulation of the securities markets.

The CHAIRMAN. Mr. Cox, Senator Proxmire would normally be next. He's been kind enough, because Senator Tower has to go conduct a hearing in the Armed Services Committee, to defer to him. So I call on Senator Tower at this time.

STATEMENT OF SENATOR TOWER

Senator TOWER. I would thank Senator Proxmire and I will not intrude too much on his time and I would suspect that my comments and questions will not be charged against his time.

I simply want to say I wholeheartedly endorse the nomination of Dr. Cox. He has a splendid academic background in economics. More importantly, that background that he acquired at the University of Chicago has been tempered by the outstanding experience of having served on the faculty of Texas A&M which doesn't have a very good football team this year, even though they have a million dollar coach, but nonetheless, is noted for the splendid faculty and the number of merit scholars that it attracts, and I think it's also a good idea to have an economist on the Commission as regulations or deregulations are proposed. I think the economic impact is as critically important as the legal aspects of the change.

So I believe Dr. Cox is eminently qualified and I'm pleased to endorse him, Mr. Chairman, and I apologize to you, Dr. Cox, and other members of the committee for this hasty intrusion. I've got the Chief of the Armed Services waiting over in the Armed Services Committee, so I will excuse myself.

The CHAIRMAN. Thank you very much, Senator Tower.

Senator Proxmire.

Senator PROXMIRE. Dr. Cox, you bring us both good news and bad news. The good news is that you do have eminent academic qualifications. I notice you were Phi Beta Kappa, magna cum laude at the University of Chicago, which is an outstanding institution. You're

a Ph.D., a professional economist, and I've felt that we need people with that kind of background in government and I have called for that and criticized those who have not got those kinds of qualifications.

Another qualification you have is that you have served at Texas A.&M., Jackie Sherrill's spot, as Senator Tower pointed out, they pay a million bucks for a coach. I understand they also pay very well for faculty members. So I'm sure you've used your economics in a very practical way to go to probably one of the highest paid universities in the country, and I think that shows your shrewdness.

Then, in addition, I think that of all the witnesses we've heard this year, you have the clearest voice and I appreciate that.

Mr. Cox. Thank you.

Senator PROXMIRE. It's emphatic; it's loud; you don't hesitate; you don't swallow your words; you don't mumble. You say things very clearly and there's no doubt what you say. That's all the good news.

I've got a little bad news here. In nominating people for important government positions it's reasonable to expect the President to choose the most qualified person among those willing to serve among those who are available. Your experience in securities matters appears to be limited to the 1 year you've been at the Commission. You indicated enthusiasm for the Commission, which I share. I think it's one of the very best, maybe the best agency in Government.

Based upon your performance at the Commission to date, four of the current five Commissioners, all but the Chairman, have indicated opposition to your nomination. In fact, they say you're not qualified. Three out of four of the opposing Commissioners were appointed by President Reagan and so it's not a matter of partisanship.

You, yourself, are quoted as saying it had never crossed your mind when you became chief economist that you would be nominated to become a Commissioner.

Will you please identify the practical, not theoretical but practical, experiences which qualify you to be among the best candidates to serve as an SEC Commissioner?

Mr. Cox. Yes, Senator. I would start with over 1 year of experience as Chief Economist at the Commission. I have been involved in various aspects of Commission business. I've worked with the senior staff in the different operating divisions. I've advised the Commission. From that vantage point, I've seen operations in all areas of the Commission.

During my academic career, I studied government regulation. I studied organized markets, not only from a theoretical aspect but from an empirical one as well. That leads me to always ask, what is the evidence? I think that that is important, whether assessing a rule at the Commission or an economic theory. What is the evidence that supports a proposal?

Senator PROXMIRE. Well, let me ask you, how do you explain the fact that these men who serve on this agency which you and I so much admire—they are the heart of the Commission—that all

except the Chairman say you're not qualified? How do you explain that?

Mr. Cox. I think it is easy to explain that Commissioner Evans preferred that I not be nominated since he wanted to be nominated for this position. As far as Commissioner Thomas, I do not know her views at all.

The two other Commissioners, Commissioner Longstreth and Commissioner Treadway, have spoken to me personally about the reports of their opposition. They told me that the entirety of their criticism is that I am not a securities attorney. They view the job of Commissioner as involving technical legal matters best suited for a securities attorney. They have explicitly told me that it was not a personal objection to me, nor did they feel that my economic credentials were in any way inadequate or that my integrity was in question.

So I would view their comments as expressing their desire to add an attorney to the Commission.

Senator PROXMIRE. Haven't most of the appointments to the SEC been people with legal backgrounds and securities attorneys, as you put it, and hasn't this resulted in an eminently distinguished Commission that has done an outstanding job?

Mr. Cox. I believe that most of the appointments to the Commission have been securities attorneys, but there are exceptions. For example, Commissioner Evans had a background in economics. He's done an excellent job.

Senator PROXMIRE. Now you have been quoted as saying that one of your primary goals at the Commission would be to see that the economic impact of proposed regulations is more carefully considered than has sometimes been the case in the past.

Will you please identify those specific instances in the past in which you believe the Commission has not adequately considered the economic impact of its regulations and that you would have done differently? What are the specific instances?

Mr. Cox. I hesitate to comment on the amount of consideration given to specific issues before the time when I was involved in either the staff or Commission decisions. However, I take my cue from comments made by, for example, Commissioner Loomis, who said that the Commission should find a way to make better use of economists and economic thinking. Also, former Chairman Roderick Hills said that economics should play a greater role. I based my statements on those.

Senator PROXMIRE. Those are generalities. It would seem to me that this is a serious criticism and I would hope that you would give us at least two or three specific examples of the failure to consider the economic impact of proposed regulations, rather than just stating that other people had made similar observations.

Mr. Cox. I could certainly give you examples where I have contributed and that I think were very important. I contributed a memorandum to the Commission regarding a revision in the tender offer rules. I think that the economic impact of that revision stood to be substantial, and it was important to take account of that change.

I have also worked to evaluate economic impacts of rule 415, shelf registration. I think the Commission would have been remiss if it had not taken account of the evidence on that.

Senator PROXMIRE. Did the Commission follow your advice on the tender offer rule?

Mr. COX. I submitted my recommendation. The vote on the rule was different than I recommended. In that sense, my advice was not followed.

Senator PROXMIRE. I realize it may be unfair to ask you off the top of your head to give us a list of specifics. Would you for the record supply us with a list in the next day or two of the economic impact of proposed regulations where they should have been considered more carefully?

Mr. COX. Yes, Senator.

Senator PROXMIRE. I'm not asking for them right now but for the record.

Mr. COX. Yes, Senator, I will do my best to get them to you by tomorrow.

[The following information was subsequently submitted for the record:]

ECONOMIC IMPACT OF REGULATIONS

Question. What are two or three instances in which the Commission should have more carefully considered the economic impact of its regulations?

Answer. I am not in a position to examine the economic analysis that the Commission considered before I became Chief Economist. In short, I do not know the precise economic justification or related analysis that was involved in particular actions. However, had I been here, I would have made sure that economic analysis was provided for the Commission on the following three rule changes adopted before September 1, 1982.

1. EXTENDING THE OFFER PERIOD FOR TENDER OFFERS

The Commission extended the minimum offer period for tender offers from ten calendar to twenty business days. This raises several important economic questions. First, would the change increase the cost of and thereby deter some tender offers? If so, was this change consistent with the Williams Act which requires neutrality between bidders and targets? Additional questions which could have benefited from economic analysis are the effects of a longer offer period on shareholders of bidding companies and on the shareholders of target companies.

2. REGULATION D

Regulation D provides a variety of disclosure exemptions for small business issuers of securities. Economic analysis would have attempted to provide an estimate of the reduction in issuing costs for small business. This benefit for small business could be compared with an estimate of the effects on investor protection of reduced disclosure.

3. NET CAPITAL REQUIREMENTS FOR BROKER-DEALERS

The Commission set lower net capital requirements for broker-dealers. An economic study would have estimated the capital reserves that would have been released for alternative uses and the cost saving for the firm. This should be compared with the added risk to customers from the lower capital reserves. Furthermore, evidence would have been provided on how the trend toward publicly held broker-dealers influenced the stability of capital in broker-dealer firms.

Senator PROXMIRE. Now in recent testimony—this was July 17 of this year before a House subcommittee, there was a sharp difference among Commission members on the desirability and ability of

the SEC to arrive at specific or even approximate cost-benefit figures for Commission rulemaking.

To what extent would you require hard data on cost versus benefits in considering regulatory rulemaking proposals?

Mr. Cox. I advocate a cost-benefit approach, but it is often very difficult, if not impossible, to estimate all of the costs and benefits. The advantage that I see of cost-benefit analysis is that it narrows the range of uncertainty. You can be specific about what costs can be estimated precisely and what costs cannot. Also, with respect to benefits, some benefits can be estimated precisely, while others cannot be so estimated. I think that improves decisionmaking. I certainly wouldn't say that all costs and benefits can be estimated precisely.

Senator PROXMIRE. Well, I appreciate that. Let me see if I understand what you've told me. Do you acknowledge, then, that many of the benefits of the Commission's regulations are not quantifiable and that in such cases no hard data should be required when considering proposed rulemaking?

Mr. Cox. I believe it is often extremely difficult to quantify some benefits, and in the timeframe in which decisions are made you cannot require precise estimates of all costs and benefits.

Senator PROXMIRE. Now do you believe it's appropriate that the enforcement division initiate enforcement proceedings which involve only a single registered representative of a broker-dealer accused of misconduct concerning a customer's account?

Mr. Cox. Yes, sir.

Senator PROXMIRE. My time is almost up, but I'd like to follow up, if I might, Mr. Chairman, with just one question relating to that.

Is it important that the Commission have a presence in these types of cases, particularly because experience indicates that the SRO's very rarely bring such enforcement proceedings? If the Commission fails to act in these cases, no one else will. Damaged customers can initiate private civil lawsuits which doesn't protect the public from potential future misconduct. I take it that your response is that the enforcement division should initiate enforcement proceedings involving only a single registered representative broker-dealer and you feel that's an important part of their responsibility.

Mr. Cox. In cases of egregious violations, I certainly think it's appropriate for the enforcement division to single out an individual.

Senator PROXMIRE. Thank you. My time is up.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Excuse me, Mr. Chairman, I would like to vote on Judge Clark's nomination, so I have no questions to ask. I did want to hear your testimony and thank you very much.

Mr. Cox. Thank you.

The CHAIRMAN. Thank you, Senator Hecht.

Senator D'Amato.

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Cox, would you please comment on the Commission's recent actions regarding disclosures of executive compensations?

Mr. Cox. Yes, Senator. There were changes made in the executive compensation disclosure. I think the way they were reported in some press accounts was sensationalism rather than facts.

I think it would have been better to carefully analyze the situation before the change and compare it with the situation after. Let me do so.

The comments have mainly related to disclosure of management perquisites. In that case, the Commission left the threshold level for specific disclosure of perquisites at the level it had been either $25,000 or 10 percent of the executive's salary, whichever is less. Any perquisites above that level have to be reported specifically. Below that level, the perquisites do not have to be reported.

Under the situation prior to the change, perquisites that fell below the threshold level were lumped with other compensation so an investor had no way of telling what the executive's perquisites were. Therefore, I believe that the decision was a careful one, consistent with the other changes to increase investor information about executive compensation.

Senator D'AMATO. You're in favor of it?

Mr. COX. Yes, sir.

Senator D'AMATO. What about the problem of perception? Do you see a problem that it may be perceived as doing exactly the opposite of what you say you're in favor of?

Mr. COX. I see it was reported that way in the press.

Senator D'AMATO. Well, maybe the Commission has a duty to consider those things before it makes a decision. Do you think it went about making that decision in the right way?

Mr. COX. I don't know precisely the process it went through before making the decision.

Senator D'AMATO. What should the priorities of the Commission be with respect to the division of enforcement?

Mr. COX. My view of the proper priorities in enforcement is that the Commission needs a balanced program. That would include fraud by reporting companies, oversight of regulated entities, the traditional enforcement areas, and it would also include specialty areas such as insider trading and manipulation. It would be incorrect to focus on one area to the exclusion of the others. It would be equivalent to a police department that said they would concentrate on theft while ignoring murders or arson.

Senator D'AMATO. Have you focused in at all on insider trading and whether or not we need a new definition to clearly define insider trading?

Mr. COX. I strongly support the Insider Trading Sanctions Act. I view insider trading as a reprehensible violation of fiduciary duty that transfers wealth from trusting investors to dishonest insiders. So I support the Insider Trading Sanctions Act, which will provide a deterrent to that kind of activity.

There are two sides to the question about a definition. I have weighed those and concluded that the law should provide a careful guide to behavior that is permissible and that is prohibited. Although it would not be easy, I believe that Congress, looking at past case law, could enact a definition of insider trading that would not unduly restrict the Commission's enforcement.

Senator D'AMATO. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Mr. Cox, when did you come to the Commission as the Chief Economist?

Mr. Cox. September 1982.

Senator SARBANES. So you've been there now just over 1 year?

Mr. Cox. Yes, sir.

Senator SARBANES. And as I understand it, that was a newly created position?

Mr. Cox. Yes, sir.

Senator SARBANES. Do you know what the rationale was for its creation?

Mr. Cox. I do not know precisely. I believe it was the desire of the Commission to create an economics department oriented toward research.

Senator SARBANES. Well, there's another division that does economic research as well, isn't there, at the Commission?

Mr. Cox. Yes, sir.

Senator SARBANES. What's the distinction, as you perceive it between the responsibilities of that division and your office?

Mr. Cox. I would describe it as follows: The Office of the Chief Economist is organized to bring economists with the latest and most technical training in economics to work on Commission projects. The other division, the Directorate of Economic and Policy Analysis, the one to which you referred, has a number of tasks of a statistical nature, of ongoing monitoring of a sort different from concentrated research on specific Commission issues.

Senator SARBANES. How large is your office?

Mr. Cox. Presently, there's a staff of five.

Senator SARBANES. And how many professionals of the five?

Mr. Cox. Three.

Senator SARBANES. Yourself and two others?

Mr. Cox. Yes, sir.

Senator SARBANES. And how large is the Directorate?

Mr. Cox. I think it's 35 or 37.

Senator SARBANES. And how many professionals there?

Mr. Cox. I'm not sure, sir.

Senator SARBANES. Do you have any rough idea?

Mr. Cox. I think about 20.

Senator SARBANES. So you're not familiar, I take it, and have not looked into it since you came into the job, the thinking that went into creating the Office of the Chief Economist?

Mr. Cox. I have not inquired about it; no, sir.

Senator SARBANES. How did you come to be the Chief Economist?

Mr. Cox. I was contacted, asked if I were interested in being considered as chief economist of the Securities and Exchange Commission. I expressed an interest. I came to Washington and interviewed at the Commission with Division Directors, senior staff, and Commissioners. I'm aware that a number of economists were considered. I was chosen on a competitive basis.

Senator SARBANES. You were teaching at Texas A&M. You had not previously been, I take it, much involved in the securities field. Is that correct?

Mr. Cox. I had never been employed in the securities industry; no, sir.

Senator SARBANES. Had your economic research up to that point at Ohio State and then at Texas A&M encompassed much work in the securities area?

Mr. Cox. My work had concentrated on the economics of Government regulation, evaluating benefits and costs that it imposes. I have done research on organized markets, focusing specifically on information and the role it plays in a market. I view that as relevant to my job at the Commission, since information is one of the keystones of Commission work.

Senator SARBANES. Well, I understand that, but you would not say that your work in the economics field with respect to regulation has focused or concentrated in the securities area, would you?

Mr. Cox. That's correct. It did not focus on the securities area.

Senator SARBANES. Now you said you were contacted about becoming the Chief Economist. By whom?

Mr. Cox. I was contacted by one of the people who worked in the Office of the Chairman.

Senator SARBANES. Well, one is always interested in how these things come about, and I want to address the same line of questioning on the nomination for the Commissioner, since it appears that the Chief Economist position was a preliminary step. In other words, someone on Chairman Shad's staff contacted you and asked you to apply for this job? Is that what you're telling us?

Mr. Cox. Yes, sir. I was contacted and asked if I would be interested in being considered.

Senator SARBANES. Do you know why it was they contacted you?

Mr. Cox. I do not know precisely. I believe that they had cast a wide net asking who would be a good economist for the job; and my name surfaced in that search.

Senator SARBANES. From where, do you know?

Mr. Cox. I do not know.

Senator SARBANES. Had you known Chairman Shad?

Mr. Cox. No, sir.

Senator SARBANES. In other words, you're teaching at Texas A&M and then one day this inquiry comes, would you be interested in becoming the Chief Economist of the Securities and Exchange Commission; is that correct?

Mr. Cox. Yes, sir.

Senator SARBANES. And you have never figured out how that happened?

Mr. Cox. No, I do not know precisely. I know that the decision had been made to set up an Office of the Chief Economist and a search was going on for someone to head that office.

Senator SARBANES. Well, were you surprised at being approached or did it seem to you as just sort of a natural evolution of your career?

Mr. Cox. I wasn't surprised that I would be considered, since my work had been high quality and I had established a good reputation in the field.

Senator SARBANES. Is it your assumption that someone recommended you to Chairman Shad for the Chief Economist position and that's why they got in touch with you?

Mr. Cox. I suspect that someone recommended me to the staff members who were doing the searching; yes, sir.

Senator SARBANES. And do you have any idea who that might have been?

Mr. Cox. No, I don't.

Senator SARBANES. Do you think it was some of your former professors, or people you had worked with, or what?

Mr. Cox. That could well be.

Senator SARBANES. Could it be just unknown?

Mr. Cox. I don't know precisely; no, sir.

Senator SARBANES. Do you have any idea?

Mr. Cox. I think it could have been professors I worked for in doing my dissertation. It could have been people that knew me in the profession.

Senator SARBANES. Well, taking it on down the road, how do you understand that this nomination to become Commissioner came about?

Mr. Cox. The Chairman asked me if I would be interested in serving as a Commissioner. I said that it was a challenge that I would like to try.

Senator SARBANES. When did that occur?

Mr. Cox. Early March of this year.

Senator SARBANES. You had been at the Commission at that point for how long?

Mr. Cox. Since September of the year before, 7 months.

Senator SARBANES. Did the Chairman indicate why he was proposing that you be a Commissioner?

Mr. Cox. I don't remember his precise statement. I think the purpose is to maintain a balance on the Commission.

Senator SARBANES. What kind of balance?

Mr. Cox. A balance of economics and law. As I have said, I think that law and economics are complementary in the job that the Commission does.

Senator SARBANES. You mean a balance among the members?

I don't quite understand the balance point you thought the Chairman was seeking to maintain.

Mr. Cox. Most of the members on the Commission have legal backgrounds. The balance is not to have every Commissioner be a securities attorney.

Senator SARBANES. He indicated that to you, that he didn't want to have a securities attorney but wanted to have an economist?

Mr. Cox. Not precisely that way, Senator. He said that a balance would be a good idea; that I would do a good job looking at the big picture, as far as economics.

Senator SARBANES. Well, my time is up, and I will come back to this. Let me just get one point clear in my mind. The notion that you should become a Commissioner was initiated to you by the Chairman? It was not something that you had considered, or sought, or in any way tried to place a claim for; is that correct?

Mr. Cox. That is correct.

Senator SARBANES. Well, my time is up. I'll come back.

The CHAIRMAN. Mr. Cox, the involvement of institutional investors in the securities markets has increased dramatically over the past several years. According to a recent estimate by the Pensions and Investment Aids Journal, 38 percent of the stock of the Fortune 500 firms traded on the New York Stock Exchange is owned by institutions compared with 17.6 percent in 1960. Reflecting institutional involvement, the average daily number of block trades

10,000 or more on the exchange have increased dramatically from 9 in 1965 to 1,461 in September of this year.

What role do the small investors have in the securities market today with that kind of a dramatic shift in institutional investors? What kind of role do they have and do you feel that small investors can successfully compete in markets that are continually being more institutionalized?

Mr. Cox. I think that small investors are still the backbone of the securities market system. Even though the amount of shares traded has tipped toward institutions, the small investors still make up the bulk of the number of trades. I think that, with the Commission's protection, small investors can successfully compete and trade in the securities markets today.

The CHAIRMAN. What effect, if any, does this have on capital formation? Some people would argue that it makes capital raising more efficient, while others say that increasing institutional involvement is harmful as institutions are usually more risk-averse than other investors. What's your view?

Mr. Cox. I agree with the former view. I do not know of evidence indicating greater risk-aversion of institutions.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. Dr. Cox, a recent edition of Barron's, in September of this year, had an interesting article on the exchange and the national market system entitled "Off the Record, Over-the-Counter, OTC, Is Favored Over the New York Stock Exchange." The article indicated how difficult it is for companies to delist from the New York Stock Exchange and that NASDAQ and the over-the-counter market:

> Has many heavy-hitting customers who won't switch to the New York Stock Exchange.

The article went on to point out:

> And who knows how many potential customers who would like to but can't switch to NASDAQ. It's not only hard to get listed on the New York Stock Exchange, but, brother, is it hard to delist. Indeed, delisting not only requires that two-thirds of the company's shareholders be gathered to vote, but less than 10 percent of them cannot oppose the act, not for sissies, this.

Now you have a reputation as one who favors increased competition in the marketplace. Why should delisting from an exchange be made so difficult and what rule changes, if any, would you favor at the exchange?

Mr. Cox. That is precisely a question I have asked in my role as chief economist at the Commission. I have suggested that delisting requirements be examined. In addition, I have suggested that other requirements, such as the Federal Reserve margin requirements and their relation to exchange trading versus over-the-counter trading be examined. I have not studied these issues. I do not have a position to take, but I think it is a question that bears examination. As a Commissioner, I would look into it.

Senator PROXMIRE. Well, can't we get a little more specific assurance than that? It seems to me that with your faith in the free market that you have demonstrated so emphatically and clearly, how could you possibly support a provision which requires that two-thirds of a company's shareholders be gathered to vote and less

than 10 percent of them can't oppose the action to get delisted. Doesn't that seem to be an extraordinary interference just on its face?

Mr. Cox. I don't know that I would say extraordinary, but I was surprised when I became aware of it and I certainly advocate examining it.

Senator PROXMIRE. Well, not just examining it. You can examine anything. I'm talking about whether or not, unless they come up with an extraordinary explanation of it, why wouldn't you fight against that hard if you really believe in competition?

Mr. Cox. I do believe in competition, but as I pointed out, I always ask, what is the evidence; and before I have examined the evidence, I prefer not to take a position.

Senator PROXMIRE. Now what kind of evidence would convince you that the rule should remain in place?

Mr. Cox. The first thing I would like to hear is a statement as to what purpose it serves. Next, I would like to talk to issuers that have considered delisting. I would like to know if they considered it and abandoned it because they found the delisting requirements so onerous? I'm not talking about a general statistical study, but comments from the parties involved would be the first step.

Senator PROXMIRE. Well, as chief economist of the SEC, it would seem to me that even in the short period as a year you might very well get into this and challenge it. After all, one of your functions as chief economist is to see that our economic system functions competitively, and this does seem to be an anticompetitive provision.

Mr. Cox. I repeat, Senator, that I did become interested in it and it is on my list.

Senator PROXMIRE. Now current data indicates that Rule 19(c)(3) has not had any negative impact on the trading markets; rather, it has had a slightly positive effect by narrowing the spread between a bid and offer.

Assuming that this is in fact the case, what is your position regarding Rule 19(c)(3)? Should it be exapanded?

Mr. Cox. I want to be perfectly clear whether the Senator is referring to 19(c)(3), the elimination of off-board trading restrictions, or whether the Senator is referring to the experiment linking the over-the-counter and exchange markets.

Senator PROXMIRE. All right. Well, let me just make this little explanation. In 1975, Congress charged the Commission with facilitating the creation of a national market system, as you know. The Commission has not yet finished that task. Its latest decision in this area last July was to resolicit comments on Rule 19(c)(3). This decision was subject to criticism in certain quarters as further foot dragging on the part of the Commission.

That's why the first question was, assuming that is in fact the case, what's your position regarding Rule 19(c)(3)?

Mr. Cox. I support the prohibition of off-board trading restrictions in Rule 19(c)(3).

Senator PROXMIRE. And in its 1976 report to Congress the Commission explained the legal theory underpinning its management fraud disclosure cases by stating, and I quote now:

A disclosure system is oriented to the basic interest of investors, but it doesn't speak exclusively to financial relationships and data. Disclosure requirements also should facilitate an evaluation of management stewardship over corporate assets. In this context, investors should be vitally interested in the quality and integrity of management.

Do you share that view and, as Commissioner, would you continue to assert that theory?

Mr. Cox. Yes, sir.

Senator PROXMIRE. Do you believe it should be illegal under U.S. law for a public corporation to secure foreign business by making payments to foreign individuals?

Mr. Cox. Yes, sir. Bribes have no place in a competitive market. They are inconsistent with competition and they damage a market system.

Senator PROXMIRE. What's your understanding of the Foreign Corrupt Practices Act? Do you think the act has been beneficial to shareholders of U.S. public corporations? Let me ask you that question first.

Mr. Cox. As far as prohibiting bribes, yes, because as I just stated, bribes have no place in a free market system. From that standpoint, it benefits investors and the economy as a whole.

Senator PROXMIRE. Now do you believe that the Federal Government has a role in assuring that public corporations maintain an adequate system of accounting controls?

Mr. Cox. Yes, sir.

Senator PROXMIRE. Do you support the accounting provisions of the act?

Mr. Cox. I support the idea that there should be adequate internal controls so that management will know what's going on and there will be no financial fraud.

Senator PROXMIRE. Well, I'm sure everybody does that, but my question was with respect to the act itself. Do you support the accounting provisions that are in the law now?

Mr. Cox. Senator, I support simplification and clarification of the act that preserves its objectives.

Senator PROXMIRE. How would you simplify and clarify the act?

Mr. Cox. I think that Senate bill 414 is a reasonable approach.

Senator PROXMIRE. Well, the act in its present form, it seems to me, has worked quite well. As you know, we had tremendous scandals before that and an SEC investigation indicated that there were some $300 million in questionable payments made to foreign corporations over a short period before that, and it seems to have stopped that. You indicate that you favor the purposes of the act.

Why should we, as you say, clarify and simplify?

Mr. Cox. Clarify and simplify, while preserving the objectives of the FCPA.

Senator PROXMIRE. Specifically, what needs to be simplified and clarified?

Mr. Cox. I think that the accounting requirements, the books and records requirements, should be clarified so that honest businessmen who want to comply know how to do so.

Senator PROXMIRE. Well, I'm not satisfied with that. Will you give me just a brief memorandum for the record indicating why

you think honest businessmen now have difficulty complying with the act?

Mr. Cox. Yes, sir. I'll be glad to do that.

[The following information was subsequently submitted for the record:]

FOREIGN CORRUPT PRACTICES ACT

Question. What difficulties have businessmen had complying with the accounting provisions of the Foreign Corrupt Practices Act?

Answer. Businessmen have expressed uncertainty as to the precise scope of the accounting provisions and concern that they may unintentionally violate the Act. Their concern stems largely from problems of interpretation, particularly as they relate to the breadth of the requirement that they maintain accurate books and records. On its face the Foreign Corrupt Practices Act would seem to result in liability for any inaccuracies. There will always be some inaccuracies in books and records due to honest human error. Liability for these kinds of mistakes was not intended by Congress, so I believe that it is desirable to clarify and eliminate such uncertainties.

Senator PROXMIRE. Now the Commission has requested public comment on the desirability of establishing one or more self-regulatory organizations, SRO's, in order to aid the Commission's periodic inspection of investment companies. Preliminary data provided by the Commission indicates that the SRO inspections would cost more to conduct than would comparable SEC inspections.

In addition, Commission oversight of the SRO inspection program would cost about $1 million a year.

In this light, do you support the creation of an SRO as opposed to merely providing the Commission with the necessary resources through appropriations or by charging fees to those companies it inspects?

Mr. Cox. I support the concept of SRO's with adequate Commission oversight. Your suggestion that it would be more costly for the SRO's to conduct regulation of investment companies than to have the Commission do it, is something that I hadn't heard, something that I would look into.

If that's the case, I believe that serious consideration should be given before moving forward with an SRO proposal for investment companies.

Senator PROXMIRE. My time is up but let me just point out and see if you have a response to this. There's practically no support for this, as I understand it, in the industry and it's proposed that it's considered to be a most cost inefficient method of increasing SEC inspection capabilities.

You, as an expert in cost analysis and economic effect of these regulations, it seems to me, might be in a pretty strong position to evaluate that.

Mr. Cox. I assure you I am not for cost inefficient regulation.

Senator PROXMIRE. Well, I'm sure that's true, but I would hope you would reconsider your position on SRO's in light of the appearance that it may be cost inefficient.

Thank you, Mr. Chairman. My time is up.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Mr. Cox, after this first meeting with Chairman Shad in March 1983 in which he broached to you the idea that you should become a Commissioner, how did this nomination then unfold from there?

Mr. Cox. I talked to members of the Presidential personnel staff at the White House. I explained my ideas and my views. I believe that a number of people were considered and from them I was chosen by the President and nominated to this spot on the Commission.

Senator SARBANES. So you had this talk with Chairman Shad and then you talked to—with whom did you talk at the personnel staff level?

Mr. Cox. I talked to several people, Senator: Mr. Chris Hicks, Mr. Richard Kinser, Mrs. Helene Von Damm.

Senator SARBANES. Did you discuss your nomination with other people outside of the Government?

Mr. Cox. I discussed my views, yes, sir.

Senator SARBANES. With whom?

Mr. Cox. With friends and colleagues, with people from the securities industry.

Senator SARBANES. In other words, you met with potentially interested parties to discuss your nomination?

Mr. Cox. I talked to people who are interested in the SEC; yes, sir.

Senator SARBANES. With whom was that?

Mr. Cox. I talked to Mr. Ben Smith, a specialist on the New York Stock Exchange. In connection with a demonstration of the NASDAQ trading system, I met Mr. Gordon Macklin, head of NASD.

Senator SARBANES. Anyone else?

Mr. Cox. No, sir.

Senator SARBANES. When did those conversations take place?

Mr. Cox. To the best of my recollection, I talked to Mr. Smith in April. I talked to Mr. Macklin in May.

Senator SARBANES. Now what was the nature of those conversations?

Mr. Cox. My notion of the role of economics at the SEC.

Senator SARBANES. Did the conversations touch upon your views on matters that might come before the Commission?

Mr. Cox. They touched on the securities industry and economic analysis, any of which could have come before the Commission.

Senator SARBANES. Well, did it reach the point of discussing particular matters?

Mr. Cox. We talked about the market linkage experiment.

Senator SARBANES. And what did you indicate with respect to that?

Mr. Cox. I indicated my desire for more data to determine the impact of that experiment. I stated that I was dissatisfied with the results that seem to show nothing.

Senator SARBANES. Did you understand these meetings to be in the nature of effecting support for your nomination for the Commission?

Mr. Cox. I believed them to be connected with it; yes, sir.

Senator SARBANES. And therefore, did you have a sense that the positions you reflected on the matters under discussion would affect whether you were supported or opposed for the Commissionership?

Mr. Cox. Yes, sir. I certainly believed that if I appeared to be a fool I wouldn't be supported. I talked about my view of economics and what it could contribute.

Senator SARBANES. In other words, it was your perception that what was being explored was the quality of your views and not the particular view on some matter; is that correct?

Mr. Cox. Yes, sir.

Senator SARBANES. So that even if your view was contrary to the view of the interested group, that wouldn't matter as long as the quality of the position you took was of the first order.

Mr. Cox. That's what I believe; yes, sir.

Senator SARBANES. Now if we wished to look at the quality of your work on the Commission, what would we look at?

Mr. Cox. I think that the best job that the Office of the Chief Economist has done is evaluating the impact of the shelf registration rule on cost of issuing securities.

Senator SARBANES. Well now have you submitted recommendations to the Commission from time to time on matters pending before them?

Mr. Cox. Yes, sir.

Senator SARBANES. How often have you done that in the course of 1 year?

Mr. Cox. I'd say that I have probably submitted five—six memorandums, maybe more.

Senator SARBANES. Have they been provided to the committee?

Mr. Cox. I don't know, sir.

The CHAIRMAN. No.

Senator SARBANES. Would it be possible for you to provide those, Mr. Cox?

Mr. Cox. I believe that several of them have been released publicly. As far as the others, I will contact the Commission for their permission to release them; yes, sir.

Senator SARBANES. Now what do you understand the role of the SEC to be in terms of its relationship to the executive branch of the Government?

Mr. Cox. I believe that the executive branch nominates members of the Commission. I think that is its main relationship.

Senator SARBANES. How responsive do you think the Commission should be to executive branch views on policy?

Mr. Cox. The Commission should consider anyone's views, the administration included, but it should always keep in mind that its job is to administer and enforce the securities laws as enacted by Congress.

Senator SARBANES. What is your view on the position the Commission should take with respect to its budget when it comes before the Congress?

Mr. Cox. Senator, I know the impact of the budget on the Office of the Chief Economist. I have fewer facts about the budget picture for the Commission as a whole, but I'll give you my view.

Lately, the workload of the Commission has been increasing sharply. If you look at the number of new issues, the volume of trading, the number of broker-dealers, they have been going up rapidly. At the same time, the staff of the Commission has been decreasing.

For the past couple of years, the Commission can point with pride to substantial increases in productivity that allowed it to maintain its high presence in administering and enforcing the law. But you cannot continue to get more from less.

As a Commissioner I would examine the budget question, but I think it's unlikely that the SEC can maintain its high presence without an increase in the budget.

Senator SARBANES. Well, do you think Chairman Shad was wrong when he accepted the OMB mark in coming to the Congress and ended up in a sharp difference with the other four Commissioners about the Commission's budget?

Mr. Cox. I don't know, Senator. I did not review the statistics that went into that decision. My comments on what is going on as far as workload and staff——

Senator SARBANES. I'm not going to accept that answer. That was a fairly sharp issue around here and at the Commission, and it pitted the Chairman on the Commission's budget request with his other Commissioners. You're about to become a Commissioner.

What's your view on that particular—you're being nominated to become a Commissioner. What's your view with respect to that important budget issue which, after all, goes to the very heart of whether the Commission is going to have the resources to do its job?

Mr. Cox. My view is that the Commission must have an adequate budget.

Senator SARBANES. Well, what was your view on that issue when it occurred not so very long ago.

Mr. Cox. Yes, sir. My view was that if the Commission could maintain its high presence on the budget requested, then it was adequate and valid.

Senator SARBANES. Do you think the Commissioners were right to differ with the Chairman on that budget issue and come to the Congress about it?

Mr. Cox. I certainly think that the Commissioners should express their views. That is their job.

Senator SARBANES. Were they right to do so in that instance?

Mr. Cox. Yes, sir, if they truly believed the budget was inadequate, they should have done it.

Senator SARBANES. Would you have done it, if you were a Commissioner at that time?

Mr. Cox. Yes, sir.

Senator SARBANES. You would have?

Mr. Cox. Yes, sir.

Senator SARBANES. You would have differed with the Chairman on that issue?

Mr. Cox. Yes, sir.

Senator SARBANES. You thought he was wrong?

Mr. Cox. Yes, sir. If I thought he was wrong, I would have signed the letter.

Senator SARBANES. All right. My time is up, Mr. Chairman.

The CHAIRMAN. Before I turn to Senator Proxmire, let me just make a comment that I believe the process you have described as going through your nomination is absolutely typical and standard in the time that I have been here with both Republican and Demo-

cratic administrations. I've had nominees for various positions, not just the SEC, and the normal procedure is recommendations, particularly in the nature of incumbents, Secretary of HUD and Chairman of the SEC, whatever the board or commission or department is, would be expected in that position, again without regard to which party happens to control the executive branch, to make recommendations to the Office of Personnel Management in the White House as to who they would desire to put there, and then you would be interviewed.

So certainly the questions by Senator Sarbanes are proper. You answered them correctly. But I just wanted the record to indicate that at least in my experience the process you have described is no different than any process I have seen for both Republican and Democratic nominees for most any position that we've seen come before this committee in the 9 years that I've been here.

Senator Proxmire.

Senator PROXMIRE. Dr. Cox, you've already mentioned the shelf rule in response to Senator Sarbanes. I understand the Commission is scheduled to consider the fate of that rule at 4:15 tomorrow. As you know, the rule permits issuers of registered securities which it reasonably expects to sell over a 2-year period and then bring these securities to market at any time during this period with minimum delay.

Based on the extensive comments with the data you've studied to date, what's your opinion regarding the permanent extension of rule 415 in its current form?

Mr. Cox. On the basis of my studies, I support extension of rule 415 as proposed.

Senator PROXMIRE. That's good to hear. Thank you.

Now I want to followup another area that Senator Sarbanes also inquired about.

This month's edition of Nation's Business indicates that there have been significant cuts at the SEC recently. The article says:

> Shad has been cutting the SEC staff size at a time when securities are being traded at record levels. In 1980, the SEC had a staff of about 2,100. It's headed for fewer than 1,900. Shad says in effect that the Commission is more efficient. It's doing more with less. He points out that in 1982 the SEC brought 250 enforcement cases, up from 190 the year before.

Now my question is, Do you support these cuts and do you believe that in fact the Commission is more efficient with less?

Mr. Cox. I believe that the cuts were necessary because of the budget allocated to the Securities and Exchange Commission. I most definitely believe that the Commission has increased productivity over the past couple of years; yes, sir.

Senator PROXMIRE. Do you think it can do its job with this much lesser staff? As I understand it, if you do spend a little more money for adequate staff, that doesn't necessarily contribute to the deficit, does it? Isn't it true that you also raise money from the industry itself and that they support a substantial part of your operations?

Mr. Cox. You're correct, sir. There is a large payment of fees, but that goes to the Treasury rather than to the Commission.

Senator PROXMIRE. I understand it does, but my point is that if it costs more to operate the SEC and do its job, if you needed a staff of 200 or 300 more, that wouldn't necessarily mean that the gener-

al taxpayer was paying it. We could make adjustments in the fees paid by the industry to compensate for that, right?

Mr. Cox. I don't know the power of the Commission to make adjustments in the fees.

Senator PROXMIRE. Congress could do that.

Mr. Cox. Yes, sir.

Senator PROXMIRE. Now as a result of budgetary restraints and the rising number of first-time offerings, would the Division for Corporation Finance staff perform selected review rather than the current 100-percent review of initial public offerings in order to achieve a particular turn-around time?

Mr. Cox. I think that selective review can be supported. If it's done systematically on a basis that scientifically selects filings for review, it doesn't decrease investor protection.

But personally, I like the 100-percent review of first-time filings that you mentioned.

Senator PROXMIRE. Well, isn't this the very essence of the Commission's function; that is, to assure appropriate disclosures are made by companies which are in particular need of review because they have never before engaged in the public disclosure process? You say you do favor 100 percent review of first-time filings.

Mr. Cox. Yes, sir.

Senator PROXMIRE. In view of the enormous amount of money involved, and relatively modest size of the Commission in relationship to the trading going on now, why wouldn't it be wise to continue that policy of 100-percent review rather than make it selective?

Mr. Cox. I think there is every intention of continuing 100-percent review of first-time filings.

Senator PROXMIRE. What was that again?

Mr. Cox. I think it is the intention of the Commission to do 100-percent review of first-time filings.

Senator PROXMIRE. That wasn't my question. My question was, Why not extend 100-percent review beyond the first-time filings?

Mr. Cox. I see. I do not believe that can be justified. I think that selective review is adequate. Done on a systematic basis of sampling, it works to maintain investor protection at high levels.

Senator PROXMIRE. Now at several open meetings Chairman Shad has referred to studies that indicate that relatively few shareholders thoroughly review the periodic disclosure documents which are sent to them. For instance, while discussing the proration rule for two-tiered tender offers, Chairman Shad argued that it was unnecessary to extend the proration period to enable small shareholders adequate time to receive and digest proxy materials because most individuals rely on professional advice on such matters and professionals receive this information almost immediately.

Do you share that view?

Mr. Cox. Let me be clear, Senator. The view on extending the proration period for tender offers or the view that a lot of the information that investors get is not understood? I'm unclear about which one.

Senator PROXMIRE. Well, I'm not talking about the former. That was what I just discussed. I'm talking now about the proration rules for two-tiered tender offers. That's the example I'm using now. Chairman Shad argued that it was unnecessary to extend the

proration period to enable small shareholders adequate time to receive and digest proxy materials because most individuals rely on professional advice on such matters and professionals receive this information almost immediately. So I'm talking about that particular kind of situation.

Mr. Cox. Yes, sir, my recommendation supported that position.

Senator PROXMIRE. That it was unnecessary to extend the proration period?

Mr. Cox. Yes, sir.

Senator PROXMIRE. Well, I'll tell you why that's troubling to me. The disclosure requirement of the securities laws ought not to be structured so as to compel individual investors to rely on professional advice. It's one thing to say that investors using professional advice will and should reap benefits from these services, but it seems to me it's something else to have rules structured so that a reasonably diligent investor not utilizing professional advice is not provided with adequate time to make an informed decision.

Do you see my problem?

Mr. Cox. Yes, sir.

Senator PROXMIRE. I'm particularly concerned with a staff memorandum that's attributed to you on October 28, 1982. Of course, you were new in your job at that time, but you had been there a month or so. You said this—this refers to a staff memorandum on tender offers and takeovers where professional investors and market professionals have an advantage over individual investors.

You say, "Professionals have an advantage in the present system. This is no problem. It is the way markets work in all lines of endeavor."

Now that seems to me to be contrary to the thrust of the law which is designed to insure neutrality in the securities acts.

Mr. Cox. Senator, I'm glad you raised this question. Quite a bit has been made of a couple of sentences taken out of context from that memorandum.

That memorandum was some 19 pages long and addressed the question of the effect on investors of changing the proration period for partial tender offers. One small part has been singled out, but I would like to give you the full flavor of my remarks. I brought the memorandum with me.

Senator SARBANES. Excuse me. Is this one of the memorandums that you will be providing us in light of the earlier questioning?

Mr. Cox. Yes, sir. I wrote,

> The comment that professional investors have an advantage in the present system is correct. Professionals will have an advantage in any system. The professionals have invested the time and other resources to continually operate in the market. Nonprofessionals do not find that investment worthwhile. So the professionals have purchased an advantage that could be purchased by others too. This is no problem. It is the way markets work in all lines of endeavor.

I was not advocating that professionals should benefit at the expense of nonprofessionals. It was simply an analytical passage. I might as well have said that professional medical doctors have an advantage in providing medical services because they've invested in the training and have the skills to provide those services.

Senator PROXMIRE. Well, what bothers me is the time involved here. Of course, I fully understand the fact that professionals,

people who take time, obviously have an advantage over people who don't. People who go into these things in detail and study them and think about them and so forth are likely to have advantages over others, and as you say, that is the way the system works.

But when we go back to the two-tiered tender offers that I talked about before, Chairman Shad argued it was unnecessary to extend the prorationing period to enable small shareholders adequate time to receive and digest proxy materials because they rely on professional advice and the professionals get the data right away.

It would seem to me that in order to give the small investor who doesn't rely on professional advice anything like an equal shot at it, we ought to give him time.

Mr. Cox. Yes, sir. My recommendation was not based on that point.

Senator PROXMIRE. Well, would you therefore feel that it is necessary and desirable to extend the prorationing period?

Mr. Cox. No, sir.

Senator PROXMIRE. Why not?

Mr. Cox. I would still maintain the position I took. My analysis began with the question "what will be the effect on investors of extending the proration period?" The analysis went as follows: Investors in a target company that receive a tender offer will benefit. Investors in the bidding company that makes the tender offer will be harmed. That will be approximately a wash. However, there would be a net loss for investors because some beneficial tender offers would not be made due to an increase in the cost of tender offer. Those investors would suffer. That was the basis for my recommendation.

Senator PROXMIRE. My time is up, Mr. Chairman. I have just one more question, but I will defer to Senator Sarbanes.

The CHAIRMAN. Senator Sarbanes, would you let Senator Proxmire ask just one more question since that's his last?

Senator SARBANES. That's fine.

Senator PROXMIRE. The Commission currently has outstanding a concept release seeking comment on potential new alternative types of investment companies. One idea is to create an investment company that would be its own investment adviser and not have shareholders voting or an independent board of directors. It also would not be subject to section 36(b) of the Investment Company Act which places a fiduciary duty on investment companies not to collect excessive advisory fees.

What's your reaction to that proposal? Do you believe that mere disclosure of advisory fees is an adequate substitute for the substantive protections of section 36(b)?

Mr. Cox. I want to make very clear, Senator, that I would draw a distinction between the so-called money market mutual funds and mutual funds that have shares of stock, the more traditional type.

I think there's good reason to examine that proposal for the money market mutual funds because the investors' main protection is being able to vote with their feet. Their shares are always worth $1. If they don't like the way that fund is being managed, they can redeem their shares and go elsewhere.

It is my belief that investors in money market mutual funds see them as little different from a money market account in a bank.

It is a different situation if you look at traditional mutual funds. There, the value of the shares fluctuates. I do not think it is the same to say to an investor that if you don't like this company, sell your shares. That might impose a loss.

So my answer to your question is that I would distinguish the type of investment company to which this proposal applies.

Senator PROXMIRE. And you would only favor eliminating section 36(b) for money market mutual funds; is that right?

Mr. COX. From my study of the question, it is my view at this time that at least some of the section would be eliminated for such funds.

Senator PROXMIRE. Thank you.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. I wanted to pursue the previous subject Senator Proxmire was on regarding the tender offer question.

The Commission did not accept your recommendation on the additional time question; is that correct?

Mr. COX. Yes, sir.

Senator SARBANES. But you continue to adhere to that position, to your position; is that correct? You continue to think that's the proper position?

Mr. COX. I support the analysis I did, but you've got to remember there is more than one aspect to making a determination of this type.

I looked at the costs to different types of investors. There is also the fairness aspect. Once the Commission adopted the rule extending the proration period on tender offers, that is the rule that governs the securities markets and, as a member of the Commission, I support it.

Senator SARBANES. Well, if you were a Commissioner, would you feel it should be changed if it should come back before the Commission?

Mr. COX. No, sir. The Commission made a decision based on a number of inputs and I will abide by that decision. I have no intention to reopen the question.

Senator SARBANES. Well, what's your view of the validity of your recommendation in light of the position taken by the advisory committee on tender offers? As I understand, they recommended that the minimum proration period should be the same as the minimum offering period so as not to undercut the protection provided by the minimum offering period.

Mr. COX. I'm sorry. Would you please repeat the last part?

Senator SARBANES. The advisory committee on tender offers recommended that the minimum proration period should be the same as the minimum offering period so as not to undercut the protection provided by the minimum offering period.

Mr. COX. Yes, sir. That is the way the rule currently stands.

Senator SARBANES. That was not your position, though; is that correct?

Mr. COX. That is correct, sir.

Senator SARBANES. Well, what's your view of your position in light of the advisory committee's conclusion, the substance of your

position, not the argument that we've got a matter of precedent here now, but the substance of your position?

Mr. Cox. As I said a minute ago, I am willing to support the Commission's decision. As far as the recommendation by the tender offer advisory committee, it doesn't call for a change. I support the rule as adopted by the Commission.

Senator SARBANES. I understand that, because you feel that it's now been adopted by the Commission and it ought to stay in; you don't want to be changing the rules willy-nilly all the time.

Mr. Cox. Yes, sir.

Senator SARBANES. Well, that's not a bad position in an area in which we need some stability, but I'm probing to find out whether you still adhere to the substance of the recommendation you made in light of the fact that the advisory committee on tender offers has reached this very clear and contrary recommendation.

Mr. Cox. I think my analysis of the issues I addressed was correct. I will admit that there can be overriding considerations.

Senator SARBANES. Do you think a Commissioner ought from time to time to admit that he's wrong on the substance of an issue?

Mr. Cox. Yes, sir. If he sees that he's wrong, he should say so.

Senator SARBANES. Now on the budget question, you said in response to Senator Proxmire that on these budget cuts that that was the budget allocation.

Do you feel that the Commission should be constrained in their budget requests to the Congress by the figure given to them by the OMB?

Mr. Cox. Do I feel that the Commissioners should be constrained? No, sir. They should take that suggestion into account in forming their opinions, but they should not be constrained by it.

Senator SARBANES. In other words, you would be prepared to ask for more than the OMB allocation if you deemed it necessary for the Commission to do its work?

Mr. Cox. Yes, sir.

Senator SARBANES. And I understand your previous answer to me when I was questioning you about this difference between the Chairman and the Commissioners in effect to have been that had you been a Commissioner you would have signed the letter that four of the five Commissioners signed with respect to the cut in the personnel at the agency.

Mr. Cox. I did not say that, Senator. I said that if, on evaluating the situation, I reached a conclusion that the budget should have been larger, I would have made that clear and I would have signed the letter.

Senator SARBANES. Well, then, I have to pursue that line of questioning again because I wanted to get the hypothetical out of it. I'm not asking if you reach that conclusion. I'm asking you to take the factual situation which did exist, not a hypothetical. It existed, and I want to know what position you would have taken in that factual situation.

Mr. Cox. I can assure you, Senator, I would have investigated the job the Commission was doing, and I would have reached a conclusion. But without having made that investigation, I cannot say what my conclusion would have been.

Senator SARBANES. Well, Mr. Cox, you were at the Commission. You were the Chief Economist. Four of the five Commissioners signed a letter to the Congress saying that they didn't think the budget was enough to carry out the Commission's work. Do you think they should have done that?

Mr. Cox. Yes, sir. As I previously answered, if that was their view, they should have made it known.

Senator SARBANES. Was that your view of the budget situation?

Mr. Cox. I did not know the budget situation, sir.

Senator SARBANES. You have no judgment, then, on whether the four Commissioners were right or whether the Chairman was right?

Mr. Cox. I will not say who was right without more facts. I do not know how the Division of Enforcement was faring. I do not know about the size of the staff cuts and the lag in the workload of other divisions. That is the kind of information I would want to make that decision.

Senator SARBANES. Did you follow those hearings in the Congress on the Commission's budget?

Mr. Cox. Yes, sir.

Senator SARBANES. And you formed no judgment about the substance of the issue?

Mr. Cox. At the hearing I attended I heard people say that it seemed the work was being done.

Senator SARBANES. Well, is it accurate then to say that you thought the Chairman was correct?

Mr. Cox. That's what I heard. I do not know who was correct. I did mot examine the figures.

Senator SARBANES. You're nominated now to be one of five Commissioners. You're going to have to make judgments and take positions and you're going to be on the firing line. We're trying to get some sense here of the independent stature that you will bring to the making of those judgments.

Now this is a very clear issue. It's not some hypothetical thing. It was the focus of attention at the Commission and elsewhere for a sustained period of time. And yet you're telling me that you, in effect, will not make a judgment on that budget question.

Mr. Cox. I can assure you, Senator, that if I were a Commissioner, I would have looked at the facts and figures that would allow me to make a decision, an independent decision. Since I did not investigate the budget figures, I think it would be unfair for me to render a decision without those facts.

Senator SARBANES. All right.

Senator PROXMIRE. Just one more question, Mr. Chairman.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. I apologize, Mr. Chairman. I said I was through. I do have one more question.

The New York Times today reported that the SEC is currently considering preventing trading in the stripped down American Telephone & Telegraph Company until November 21. It's the feeling of some that while the prospectuses of the new stock will be issued November 15 that maybe trading should not be allowed to start immediately thereafter on November 17 and it should be postponed until November 21.

What's your feeling about that?

Mr. Cox. The question is whether investors have an adequate amount of time to evaluate the situation, and I have not thought about it. I don't know. But that is what I would base my decision on.

Senator PROXMIRE. Well, would you feel that 1 day is enough in view of the complicated situation you have in the telephone industry now with the deregulation of American Telephone & Telegraph and with the decentralization of power and so forth, and with the very complicated situation we have with the series of separate, independent companies?

Mr. Cox. One day for an investor that doesn't know anything about those issues seems a short time to me. I agree.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Mr. Cox, how important do you think it is for the Commission to act with unanimity on issues that come before them?

Mr. Cox. I think it is important for the Commission to discuss the issues and attempt to come to a unanimous decision. It helps in giving guidance to the securities industry and to investors. But if a Commissioner is convinced of his view, then I think independence dictates he should vote that view.

Senator SARBANES. Well, do you see the Chairman, as it were, as the leader amongst the Commissioners in setting the policy direction of the Commission?

Mr. Cox. No, sir. My view is that it's truly a collegiate body. They discuss, they negotiate, and they decide. They are not dictated to by the Chairman.

Senator SARBANES. Well, I don't want to use the word dictated because I would assume that would not be the case, but to what extent should the Commissioners try to follow in effect the policy lead of the Chairman in order to move toward this unanimity which you indicated in answer to a previous question is desirable?

Mr. Cox. I think the Commissioners should always give due consideration to the suggestions of the Chairman, but the Commissioners are independent. They have to follow their own beliefs, not the direction or the suggestions of the Chairman or any of the other Commissioners.

Senator SARBANES. Thank you.

The CHAIRMAN. I might say that I would like to have this committee operate on a more unanimous opinion at the direction of the chairman. However, I never expect to achieve that. I'm a realist and I've learned how to count on various issues, but it's a nice hypothetical thought.

Dr. Cox, let me say to you that I'm very impressed with your testimony. That does not necessarily mean that I agree with all of your answers. But when I say impressed with your testimony, all of us on this committee have had over a number of years the opportunity to listen to a lot of witnesses. Many of them were intimidated by the committee and they are very wishy-washy in their answers and they try to outwit us, I suppose, and guess what answer we

want to hear and fudge it if they possibly can and create as little stir as possible.

Again, regardless of whether we agree with your answers or not, they certainly have been direct and forthright and more yes and no answers and clear-cut policy statements on how you feel than most of the nominees that have come before this committee. I want to congratulate you on that. I wish more nominees had the courage of their convictions, whether they think we will agree or disagree, to just say, "Yes, sir" or "no, sir"; this is how I feel. So I appreciate that very much.

Let me say for the benefit of the members of the committee that I do anticipate that there will be some questions for your response in writing in addition to the requests that Senator Sarbanes and Senator Proxmire have asked you to submit for the record, but I would hope that staff members or other committee members who are not here would recognize that this nomination has been before the committee since before the August recess, more than 3 months, and therefore, with that amount of time for people to be aware of the nomination, Dr. Cox has assured me that he would answer these questions in writing by tomorrow, and therefore, that makes it necessary for members who were not here who do wish to ask further questions to have them to Dr. Cox by the end of business today and those responses will be back in writing tomorrow for the record.

Thank you very much for your attendance here today.

Mr. Cox. Thank you, Senator Garn, and thank you, Senators.

The CHAIRMAN. The committee is adjourned.

[Whereupon at 11:40 a.m., the hearing was adjourned.]

[Biographical sketch of nominee and response to written questions from the committee follow:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Cox (LAST) Charles (FIRST) Coleman (OTHER)

Position to which nominated: Commissioner, Securities and Exchange Commission Date of nomination: July 11, 1983

Date of birth: 8 (DAY) 5 (MONTH) 45 (YEAR) Place of birth: Missoula, Montana

Marital status: Single Full name of spouse:

Name and ages of children: None

Education:	Institution	Dates attended	Degrees received	Dates of degrees
	University of Chicago	1967-1972	A.M.; Ph.D.	1970, 1975
	University of Washington	1963-1967	B.A.	1967

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

National Fellow of the Hoover Institution, 1977-1978

Charles R. Walgreen Foundation Fellowship, 1970-1972

National Defense Education Act Fellowship, 1967-1970

Graduate Magna Cum Laude with Distinction in Economics 1967

Phi Beta Kappa, 1966

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
American Economic Assoc.	None	1975 - Present

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Chief Economist, Securities and Exchange Commission, Washington, D. C. 1982 - Present.

Assistant Professor of Management, Texas A&M University, College Station, Texas, 1980-1982.

Assistant Professor of Economics, Ohio State University, Columbus, Ohio, 1972-1980.

National Fellow of the Hoover Institution, Stanford, California, 1977-1978.

Consulting in a nonlegal capacity:

Heller, Ehrman, White & McAuliffee, Attorneys, San Francisco, California, 1978-1980.

Law Offices of David C. Buxbaum P.C., New York, New York 1979.

Jones, Day, Reavis & Pogue, Attorneys, Columbus, Ohio, 1980.

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Chief Economist of the Securities and Exchange Commission, 1982-Present

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

See attached sheet.

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Republican

PUBLICATIONS:

"The Enforcement of Public Price Controls," Journal of Political Economy, (October 1980).

"Monopoly Explanations of the Great Depression and Public Policies Toward Business," in The Great Depression Revisited, 1981.

"Futures Trading and Market Information," Journal of Political Economy, (December 1976).

Review of Demand Revelation and the Provision of Public Goods, Journal of Economic Literature, December 1981.

Review of The Pay Board's Progress: Wage Controls in Phase II, Journal of Money, Credit, and Banking, (February 1981).

Comment on "Why Monetarism is Failing," Wall Street Journal, December 22, 1980.

Review of The Lessons of Wage and Price Controls --The Food Sector, Journal of Political Economy, (December 1980).

Review of Quantitative Models of Commodity Markets, Journal of Political Economy, (June 1976).

Review of Industrial Concentration and Inflation, Journal of Money, Credit, and Banking, (February 1976).

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

I desire to maintain leave without pay status at Texas A&M University. (See attached opinion from SEC Ethics Counsel).

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

I want to rejoin the faculty at Texas A&M.

3. Has anybody made you a commitment to a job after you leave government?

Texas A&M has granted leave through August 1983. It has made no commitment past that date, although I applied for leave for the 1983-84 academic year.

4. Do you expect to serve the full term for which you have been appointed?

Yes

QUALIFICATIONS

I am qualified to serve as a Commissioner of the Securities and Exchange Commission by my ability, experience, and training as a professional economist. The Commission administers the securities laws to protect investors and increase efficiency of securities markets. Therefore, regulation promulgated by the Commission has important effects on investors' welfare, market performance, capital formation, and economic efficiency. It is appropriate that in making decisions the Commission weigh the benefits and costs (both direct and indirect) of its policies and rules. I have the ability to make these kinds of assessments and thereby contribute importantly to the Commission's deliberations.

My entire professional career has focused on analyzing the economics of government regulation. In academic employment, my research projects examined in depth various aspects of the regulation of economic activity. Furthermore, I have studied and published research on information and market efficiency in organized markets -- topics that are central to the mission of the Securities and Exchange Commission. My teaching dealt extensively with applying economic theory to questions about regulation. In school, my training benefitted from the guidance of some of the foremost authorities in the field of economics and law.

Since becoming Chief Economist of the Securities and Exchange Commission, I have had almost a year's experience in applying economic analysis to a wide range of Commission policy issues. Those issues concerned areas such as tender offers, money market funds, national linkage of securities markets, issuer repurchase of shares, and enforcement of the securities laws. My work at the Commission has shown me that economic analysis of rule proposals and regulatory policies provides valuable insights about the possible benefits or harms to investors and effects on the efficiency of securities markets.

My work as an economic researcher leads me to approach problems systematically, to ask hard questions about the effects of a proposal, and to request evidence that supports or contradicts a proposition. This approach is calculated to promote rational decision making and is a valuable complement to the skillful legal approach that is often used by Commissioners and the Commission staff.

The records that I have compiled at the Securities and Exchange Commission, as a professor, and as a student provide credentials to support my claims of qualification. At the Commission, I have demonstrated my ability and understanding of the issues to those with whom I have worked closely. In addition, I have set up a new office and recruited a staff with the ability and training to provide first-rate economic advice to the Commission. As a professor, the quality of my research and teaching favorably impressed my colleagues. They attest to this. My research has been published in the highest quality journal in the economics profession. My ability has been recognized by leading economists. Finally, my school record and awards reflects my economic skills.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

I have shares in a Merrill Lynch CMA account that I will liquidate.

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I will liquidate shares in my money market fund. If absolutely necessary, I will resign from Texas A&M University.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

Defendant in a civil suit for divorce, September 1980, in Columbus, Ohio. The terms had been agreed upon by the parties, so the divorce was granted without incident.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

RESPONSE TO WRITTEN QUESTIONS FROM THE COMMITTEE

Q. Regulation vs. Deregulation

John Dingell of the House Commerce Committee is on record as favoring additional regulation of various index option markets.

SEC Commissioner Bevis Longstreth, in an article in the New York Times (November 6, 1983), recommended a review of leveraged buyouts with a view of increasing shareholder protections.

What are your views of these two suggestions? What additional regulatory initiatives -- if any -- do you believe should be undertaken by the Commission?

A. In a letter to Chairman Shad on October 21, 1983, Chairman Dingell expressed his concern about regulation of the rate at which new index options may be introduced in the market. Specifically, he inquired whether the phase-in program proposed by the Commission is long enough. That program would limit each exchange to a maximum of two narrow-based index options until January 31, 1984. After that, new narrow-based index options that satisfy the other requirements of the Securities Exchange Act of 1934 could be introduced without additional restrictions.

As you know, the Commission is scheduled to consider this proposal next Thursday, November 17, 1983. The purpose of the phase-in program is to provide investor protection by giving the exchanges and broker-dealers a period to train their personnel and to establish effective supervision programs to monitor trading in the new products. The benefits from enhanced investor protection have to be balanced against the

harmful effects on competition among available products and resulting injury to investors that will result if the introduction of new options products is delayed too long. I question whether continuing the restrictions on the introduction of new options past February 1984 would on balance benefit investors. The exchanges and broker-dealers should be able adequately to supervise and market these products by that time. Moreover, the Commission has statutory powers and extensive regulations to ensure investor protection for options products that are traded.

Commissioner Longstreth's leveraged buyout article raises a number of important questions about investor protection. I certainly agree with the article's thrust, because there is a potential conflict of interest between management's fiduciary duty to shareholders and its proprietary interest in a leveraged buyout. With a leveraged buyout proposal, shareholder protection is partially provided by the market, because competition from other potential purchasers should deter management from offering shareholders a price that is too low as long as those competitors can make a tender offer for the firm. One issue, then, is whether devices that shield management from competing tender offers (so-called "shark repellents") prevent tender offers that provide a measure of shareholder protection. It may well be that such "shark repellents" require regulation. As a first step, the Commission should investigate the extent to which shark repellents have negative effects on tender offers and ultimately on shareholder wealth.

With this evidence, the Commission can determine which types of shark repellent devices require regulation in the interest of investor protection, or whether an alternative approach to shareholder protection would be preferable.

Q. The Role of Mr. Cox in Commission Rulemaking

The Commission's most recent annual report (for fiscal year 1982) states (at page 58) as follows:

> The Office of the Chief Economist was established during the fiscal year to enhance the Commission's long-range policy overview (and) to draw increased attention to the fundamental economic issues raised by the agency's regulatory actions ... When issues are particularly significant and effects uncertain, the ... Chief Economist may recommend that the Commission not adopt or modify a rule because the expected costs exceed the perceived benefits.

Please identify all of those particularly significant issues for which you have actually recommended to the entire Commission that it not adopt or modify a rule proposal. As you do so, please indicate those matters where you successfully counseled the Commission not to take some particular regulatory action which it otherwise may have taken.

A. As Chief Economist, my job is to provide the Commission with information based on economic research in order to aid its decision making. The Commission considers information from the Office of the Chief Economist along with information from the other divisions and offices in setting its regulatory policy.

Sometimes, I provide information with no recommendation about policy. At other times, the analysis leads me to recommend either adoption or rejection of a rule proposed by

another division. To date, there is one significant issue as to which I recommended that the Commission reject a rule proposal. I have not to date recommended that a proposed rule be modified. I have twice recommended that a rule proposal be adopted.

Specifically, I recommended that the Commission reject the revision of Rule 14d-8 that extended the proration period for a partial tender offer. This recommendation was based on analysis presented in two memoranda to the Commission. After considering this recommendation and those of other divisions, the Commission adopted the extension as proposed.

To the best of my knowledge, I have never successfully counseled the Commission not to take some particular regulatory action which it otherwise would have taken. In a collegial body such as the Commission, it would be difficult to conclude that the recommendation of one person ever caused policy to be different than it otherwise would have been, because the Commission solicits information from all of its divisions as well as comments from the public.

Q. Injunctive Actions Against Issuers

There have been reports that one member of the Commission often opposes bringing injunctive enforcement actions against an issuer rather than merely charging the individuals at the issuer who are responsible for the violations. What are your views on this subject?

A. I advocate bringing appropriate injunctive actions against issuers as well as individuals. Such enforcement actions are essential to the effectiveness of the full disclosure program since they remedy and prevent financial fraud. From the viewpoint of an efficient enforcement program, there are sound reasons for bringing actions against issuers as well as individuals. First, it is sometimes difficult to locate the individuals within a firm who were responsible for the fraud. The issuing firm can locate and monitor the individuals to prevent a recurrence more easily than the Commission. Second, bringing actions against issuers creates an incentive for management to devise and administer adequate internal controls to prevent financial fraud. This incentive would be reduced if enforcement actions were brought only against individuals.

Q. Enforcement Actions Against Broker-Dealers for Supervisory Failures

There have been reports that one member of the Commission generally opposes bringing enforcement actions against broker-dealer firms for supervisory failures on the basis that it is more appropriate to only charge the individuals who are responsible for the supervisory failures. Nonetheless, the Commission has continued to bring supervisory charges against broker-dealer firms. What are your views on this subject?

A. For essentially the same reasons in my response to the previous question, I advocate appropriate enforcement actions against broker-dealer firms for supervisory failures as well

as against the individuals who violated the securities laws. Broker-dealers have an obligation under the Securities Exchange Act of 1934 to supervise their employees adequately. In addition, it is always desirable to provide a strong incentive for broker-dealer firms to supervise their employees. Thus, enforcement actions should be brought against both broker-dealer firms and individual employees when a failure to supervise occurs.

Q. Enforcement Actions Where the Victims Were Purportedly "Sophisticated Persons"

Do you believe that it is appropriate for the Enforcement Division to initiate proceedings which involve a tax shelter scheme wherein a small number of wealthy investors were defrauded?

A. I advocate a balanced enforcement program that reaches all types of securities law violations, since this provides optimal investor protection. Therefore, the Enforcement Division should not ignore violations involving tax shelter schemes simply because a small number of wealthy investors were defrauded. In general, enforcement attention should be most heavily focused on egregious violations that most harm investors and capital markets. For small tax shelter frauds, state securities regulators may in some instances be better equipped or more appropriate to bring an enforcement action. However, the Commission should maintain a presence in this area, especially in the more serious cases.

Q. New Types of Investment Companies

The Commission currently has outstanding a concept release seeking comment on potential new alternative types of investment companies. One idea is to create an investment company which would be its own investment adviser and not have shareholder voting or an independent board of directors. It also would not be subject to Section 36(b) of the Investment Company Act which places fiduciary duty on investment companies not to collect excessive advisory fees. What is your reaction to this proposal? Do you believe that mere disclosure of advisory fees is an adequate substitute for the substantive protections of Section 36(b)?

A. I believe that there is substantial merit to the idea of unitary investment companies in the case of money market mutual funds. For traditional mutual funds that invest in stock, I have more reservations, so I would want to study the issue further. For money market mutual funds, the value of shares is always one dollar; hence, an investor who is dissatisfied with the investment company's policies can easily "vote with his feet" by selling his shares without incurring a loss. This kind of investor protection is not available with respect to traditional mutual funds for which the value of shares fluctuates or sales loads are involved. An investor who registered dissatisfaction by selling his shares could suffer a loss.

With respect to Section 36(b), while there would be no external adviser to a unitary investment company, the section

could still apply to the trustee or manager of the fund. Although the concept release includes as an option non-applicability of Section 36(b) to the fund manager, the Commission expressed an inclination to apply the section.

The question whether disclosure of advisory fees is an adequate substitute for the protections of Section 36(b) is a much larger question that involves traditional investment companies as well as the proposed unitary investment companies. A basic issue is whether the market works well enough to monitor advisory fees and to prevent overreaching solely through disclosure of such fees. Some commentators think not. Other commentators argue, however, that many suits brought under Section 36(b) are strike suits. Investment companies usually settle rather than fight such suits, but this imposes a cost on investors who hold shares in the fund. Investor protection dictates that the Commission examine the question. One alternative to relying only on disclosure of advisory fees is to retain Section 36(b) while clarifying the standards which an investment company's directors should apply in assessing advisory fees.

Q. Shareholder Proposals

This past summer the Commission amended Rule 14a-8 regarding shareholder proposals in proxy statements. Despite suggestions by some that the rule should be totally restructured, the changes essentially constitute fine tuning of the existing rule with slightly increased eligibility standards. The Commission's Directorate of Economic Policy and Analysis

("DEPA") recommended that the Commission consider rescission of Rule 14a-8, thereby stripping shareholders of the rights that it affords. You submitted no recommendation to the Commission on this controversial topic. What is your position on this matter? Has the Commission undermined the ability of shareholders to make legitimate proposals? Has it imposed excessive burdens on corporations which are required to include shareholder proposals in their proxies? Has it followed the proper course?

A. I support the changes as adopted by the Commission. Shareholder access through the proxy process is important, but the access should be balanced against the cost that frivolous, repetitive, or irrelevant proposals impose on the corporation and its other shareholders. The Commission's changes are consistent with investor protection and have not undermined the ability of shareholders to make legitimate proposals. At the same time, the changes do not impose excessive burdens on corporations. In short, the Commission followed the proper course.

Q. National Market System

In 1975, Congress charged the Commission with facilitating the creation of a National Market System. What do you see as the best way for the Commission to facilitate a national market system? What is the final form that you would like to see such a system take?

A. I believe that the Commission has diligently promoted a national market system by: facilitating the dissemination of accurate and timely transaction and quotation information for

all markets, linking all exchange markets, adopting Rule 19c-3 that prohibits off board trading restrictions for stocks listed after April 1979, experimenting with a linkage of exchange and over-the-counter trading for an initial sample of 23 of the Rule 19c-3 stocks and now all such securities, and considering proposals to require order exposure by over-the-counter market makers and to change the computerized linkage system. All of these issues are part of the complex of issues associated with a national market system. Some say that we have a national market system now; others say that the linkage experiment must be expanded to include all stocks.

I find the results to date of the linkage experiment disappointing. Price behavior of the stocks seems to be no worse with the linked trading, but there have been no significant improvements either. In one sense, the linkage has failed the market test because over-the-counter market makers such as Merrill Lynch and Paine Webber found that it was not worth their while to trade the experimental stocks. This indicates that the trading on exchanges was not leaving enough of a margin for improvements in efficiency to attract the over-the-counter trades. Since the major market makers stopped trading, volume in the linkage experiment has dried up. Certain firms are apparently considering, however, engaging in some off-board trading in the seven new operating companies resulting from the AT&T divestiture.

Currently, the Commission is considering additional public comments concerning linkage and Rule 19c-3. I think

that it is time to reassess the Commission's approach to the national market system and to consider alternatives to linkage of exchange and over-the-counter trading that would better achieve Congress's goal of a national market system. It is clear from the 1975 Amendments that Congress left the Commission much flexibility as to the form that a national market system could take. It is also important to realize that the securities markets are much different now than they were eight years ago. In particular, trading in NASDAQ, particularly for those over-the-counter securities which have been designated national market system securities, is viewed as an effective alternative to exchange listing by a number of major issuers.

One alternative that is worth considering is whether competition for listings between the exchanges and the over-the-counter market is sufficient for a national market system. Another is whether competition for listings coupled with Rule 19c-3 is sufficient. An issue that should be studied is whether exchange delisting requirements in practice restrict competition between exchanges and over-the-counter markets for listings. In any case, exchange and over-the-counter trading are very different, but both are efficient market systems. The Commission must be very careful to avoid inflicting unintended harm on the efficiency of either through attempts to homogenize exchange and over-the-counter trading in order to link them.

While I cannot at this time specify the final form that an effective national market system should take, it should be structured so that there is vigorous competition between the exchanges and over-the-counter markets. If this requires formal linkage of trading, it should evolve in a way that preserves the efficiency of both types of markets.

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